In the Supreme Court of the United States

OCTOBER TERM, 1944.

No. 427

GEORGE AND FRANCES BALL FOUNDATION,
Petitioner,

vs.

H. EARL COOK,
Superintendent of Banks of the State of Ohio in Charge of the Liquidation of The Union Trust Company, Cleveland, Ohio, Trustee,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
For the Seventh Circuit, and
BRIEF IN SUPPORT OF PETITION.

WILLIAM H. THOMPSON,
PERRY E. O'NEAL,
1350 Consolidated Building,
Indianapolis, Indiana,

PRESTON BOYDEN,
JOHN S. MILLER,
134 So. LaSalle Street,
Chicago, Illinois,

EVERETT WARNER,
Western Reserve Building,
Muncie, Indiana,

P. J. MULLIGAN,
ROGER P. BRENNAN,
1759 Union Commerce Building,
Cleveland, Ohio,

Counsel for Petitioner George and Frances Ball Foundation.

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To the United States Circuit Court of Appeals For the Seventh Circuit.

George and Frances Ball Foundation prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit entered in this case on July 7, 1944. This judgment affirmed, with some modification, a judgment of the District Court for the Southern District of Indiana, Indianapolis Division, in favor of respondent and against petitioner in the amount of $3,664,616 with interest from June 19, 1943.* Peti-

* When judgment was entered by the District Court in this case a like judgment in the same amount was entered in another case brought by respondent against George A. Ball involving substantially the same facts and issues. The judgment in each case provided that payment in whole or in part of either judgment would constitute *pro tanto* a payment of the judgment in the other case. The two cases were heard and decided together in the Circuit Court of Appeals. Contemporaneously with the filing of the petition for writ of certiorari in this case a separate but substantially identical petition is being filed by George A. Ball.

tioner's petition for a rehearing was denied by the Circuit Court of Appeals on August 9, 1944.

OPINIONS BELOW.

Neither the opinion of the Circuit Court of Appeals for the Seventh Circuit (printed in the record, R. 3034-3060, 3072-3073) nor the opinion of the District Court (printed in the record, R. 2957-2962) has yet been reported.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (U. S. C., Title 28, Section 347a). This petition is being filed before the expiration of three months from July 7, 1944, the date of the judgment of the Circuit Court of Appeals.

STATEMENT OF THE MATTER INVOLVED.

Respondent is the successor in interest to the partnership of O. P. and M. J. Van Sweringen of which O. P. Van Sweringen and M. J. Van Sweringen were the sole partners. For many years Van Sweringens dominated a holding company system which controlled a number of railroads and real estate enterprises.

a. C.T.B. and Vaness Loans.

In 1930 two companies in the Van Sweringen holding company system—The Vaness Company and The Cleveland Terminals Building Company (hereafter called "Vaness" and "C.T.B.")—borrowed respectively $16,000,000 and $23,500,000 from J. P. Morgan & Co., and pledged as collateral various securities including those which represented the controlling link between the top holding companies and the operating companies in Van Sweringens' holding company system. Van Sweringens individually guaranteed payment of each of these loans. Upon maturity of these

loans on May 1, 1935, neither C.T.B. nor Vaness nor Van Sweringens could pay. Van Sweringens, both individually and as a partnership, were insolvent to the extent of many millions of dollars.

At all relevant times Van Sweringens were officers and directors of C.T.B. and Vaness and dominated the affairs of those companies (R. 2843).

b. Van Sweringens' Relationship with J. P. Morgan & Co.

Van Sweringens had very close business relations with J. P. Morgan & Co. and the several banks associated with Morgan in the C.T.B. and Vaness loans. Morgan and associated institutions had headed underwriting groups through which more than $800,000,000 of securities of Van Sweringen companies had been publicly distributed. Morgan and other associates were acting as trustees for approximately $1,000,000,000 of securities of Van Sweringen companies (Finding No. 16, R. 2980).

c. Cleveland Bank Debts of Van Sweringen Partnership.

When the C.T.B. and Vaness notes matured on May 1, 1935, the Van Sweringen partnership owed approximately $15,000,000 to four Cleveland banks on loans made in 1930 and earlier, and these loans were in default. These four Cleveland banks are the beneficiaries of respondent's trust and the real parties in interest in this suit.

The maturity of the C.T.B. and Vaness notes and the consequent necessity of a foreclosure of the pledged collateral threatened Van Sweringens' continued control of their holding company system. For about three months after May 1, 1935, Van Sweringens negotiated with Morgan for a private sale of the collateral and concurrently attempted, without success, to induce their Cleveland bank creditors and others to provide sufficient money to buy the collateral from Morgan (R. 326, 2709).

d. Written agreement between Ball and Van Sweringens.

In August, 1935 Van Sweringens, accompanied by one G. A. Tomlinson, went to Muncie, Indiana to interest George A. Ball in the purchase of the C.T.B. and Vaness collateral. Ball had had no previous business relationship of consequence with Van Sweringens. They represented to Ball that there was a good investment opportunity in the securities that were about to be sold. After some investigation Ball concluded, together with Tomlinson, to make the investment.

Ball, Tomlinson and Van Sweringens entered into a written agreement which recited that Ball and Tomlinson would be willing to make the investment if Van Sweringens would continue in the management and direction of the various companies involved, and which provided that Ball and Tomlinson would invest $2,015,000 in a corporation (Midamerica Corporation) which would make the purchase —subscribing for 20,000 shares of preferred stock at $100 per share and 15,000 shares of common stock at $1 per share; and that they would grant to Van Sweringens a ten year option to buy 8250 shares (55%) of the common stock for $1 per share at any time after Van Sweringens had paid or adjusted their debts. Ball and Tomlinson subscribed and paid for the agreed amounts of stock. This was the only capital ever invested in Midamerica (R. 2975-2978).

e. Purchase by Midamerica of C.T.B. and Vaness collateral.

Meanwhile Morgan had published notice of the public sale—to be held in New York City on September 30, 1935—of the C.T.B. and Vaness collateral. At the sale Midamerica purchased the collateral essential for the control of the holding company system for $3,121,000, using in payment the capital subscribed by Ball and Tomlinson supplemented by a bank loan.

According to the findings of the District Court, approved by the Circuit Court of Appeals, Van Sweringens

(i) had arranged with Morgan for a grouping of the collateral favorable to the purchase by Midamerica, (ii) had persuaded reluctant associates of Morgan to acquiesce in the arrangements made for the sale, and (iii) by reason of their unusual relationship to Morgan had brought to Midamerica "the opportunity to purchase securities for $3,121,000 which, at the date of purchase, had a far greater value to Midamerica, organized and officered as it was." (R. 2980, 2981.) As already noted, the collateral Midamerica bought had been pledged with Morgan by C.T.B. and Vaness of which Van Sweringens were the dominant directors.

The two Van Sweringens became president and vice-president, respectively, of Midamerica and continued to manage its affairs until their respective deaths. M. J. Van Sweringen died December 14, 1935 and O. P. Van Sweringen November 23, 1936. For their services to Midamerica during the period from September 30, 1935 to November 23, 1936 the Van Sweringens were paid over $133,000 by Midamerica (R. 950, 966).

Both Van Sweringens died insolvent. They did not during their lifetime pay or adjust their debts—which by the terms of the written contract with Ball and Tomlinson was a condition precedent to the exercise of their right to acquire 8250 shares of Midamerica stock.

f. Midland Bank Situation.

Midland Bank of Cleveland (one of respondent's beneficiaries and a real party in interest in this suit) had been a participant with Morgan in the loan to Vaness. Midland had manifested some reluctance to go along with Morgan in the public sale of the collateral (R. 900, 901). It was thereupon arranged by Tomlinson, who was a director of Midland, that whatever Midland got as its share from the foreclosure of the Vaness collateral, it could invest in Midamerica stock on the same terms as he and Ball were in-

vesting, i.e., 55% of the common stock would be subject to the option to Van Sweringens (R. 902-904). Midland's share of Midamerica stock (1006 shares of preferred and 754½ shares of common) was supplied by Tomlinson. At all times before the deaths of Van Sweringens Midland treated its Midamerica common stock (754½ shares) as subject to the option to Van Sweringens "to the extent of 55% thereof" (R. 1390-1392).

After both Van Sweringens had died Ball, Tomlinson and Midland all treated Van Sweringens' interest in Midamerica stock as having terminated (R. 983, 1400).

In December, 1935 Ball agreed to buy all of Tomlinson's Midamerica stock and by April 1, 1937 had acquired most of it. On that date Ball held 14,050 shares which he transferred as a gift to petitioner, George and Frances Ball Foundation, an Indiana charitable corporation.

Later in April, 1937 the Midland Bank made an absolute and unconditional sale—on terms inconsistent with the existence of any rights in Van Sweringens—of all its Midamerica stock to petitioner at a profit of over $500,000. The other three Cleveland banks for whom respondent sues had a financial interest in Midland, and they approved or ratified the sale and benefited from it in the amount of over $380,000.*

g. Claims made by Cleveland Banks and Partnership Receiver.

Shortly after O. P. Van Sweringen's death representatives of two of the Cleveland banks which were credi-

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* Midland was in liquidation under an arrangement by which Cleveland Trust assumed all of Midland's liabilities. Other Cleveland banks agreed to share with Cleveland Trust in designated proportions any loss incurred in this liquidation. At all relevant times it has been clear that the liabilities would exceed the assets. Thus every dollar realized from Midland's assets decreased the ultimate liability of these participating banks.

tors of the Van Sweringen partnership asserted to Ball and Tomlinson a claim that the rights of Van Sweringens under the option continued; and later upon the appointment of a receiver for the Van Sweringen partnership, the receiver likewise asserted a claim to the 8250 shares (R. 981-984). The receiver later sold all of the assets and rights of the partnership to respondent who was to hold them in trust for the four banks in the proportions of their respective claims against the Van Sweringen partnership (R. 726-733).

h. Proceedings in lower Courts.

On March 31, 1943, respondent commenced the present action. By consent of the parties the record in a case previously tried, but still pending in the District Court, by respondent against George A. Ball—involving substantially the same facts and issues—was made a part of the record in the present case (R. 140, 141). The District Court held—substantially in accordance with respondent's contentions—that the agreement between Ball, Tomlinson, and Van Sweringens was in substance that Van Sweringens were to procure a bargain purchase of the C.T.B. and Vaness collateral in return for 55% (8250 shares) of the common stock of Midamerica; that Ball and Tomlinson were to provide all the capital for which they were to get preferred stock and 45% of the common stock of Midamerica; that the option provisions of the written contract between Ball, Tomlinson and Van Sweringens were designed to and did hinder, delay and therefore defraud Van Sweringens' creditors; that Ball held the 8250 shares of common stock as a resulting trustee for the Van Sweringen partnership; that when on April 1, 1937 he transferred to petitioner all the Midamerica stock he held he converted the 8250 shares; that when petitioner accepted said shares and exercised dominion over them, it also converted the 8250

shares; and that petitioner was liable in damages in the amount of $3,664,616.*

A Special Master to whom a portion of the case was referred found that Van Sweringens, by their activities in connection with the purchase of C.T.B. and Vaness assets by Midamerica, had committed fraud and a breach of fiduciary duty** (R. 2847-2849). The District Court confirmed and adopted the finding of breach of fiduciary duty, but not the finding of fraud (R. 2898-2900). The Circuit Court of Appeals also agreed that Van Sweringens had violated their fiduciary duties (R. 3055, 3056).

The Circuit Court of Appeals modified the judgment by holding that Midland Bank's conduct estopped respondent from asserting a claim on its behalf, and reduced the judgment by 55% of the amount paid by petitioner to Midland for the common shares sold to it by Midland (R. 3059, 3060, 3072, 3073). The reduction is less than $400,000.

i. Position of Petitioner.

It is the position of the petitioner that—

(1) The only agreement ever made with Van Sweringens by Ball and Tomlinson was the written agreement

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* After the deaths of both Van Sweringens, C.T.B. and Vaness each sued Ball, petitioner and one Bernard claiming that Van Sweringens had violated their fiduciary duties to C.T.B. and Vaness in connection with the purchase of the collateral by Midamerica; that Midamerica was therefore the constructive trustee of the assets purchased; that Ball, petitioner and Bernard were participants with Midamerica; and that they should be required to account for any profits received (R. 2993-2994). The C.T.B. and Vaness suits were settled through the payment by petitioner of $662,500; and Ball, petitioner and Bernard received releases from C.T.B. and Vaness (R. 2988-2993). In rendering judgment in the instant case the District Court allowed a credit in the amount of 55% of this $662,500 (R. 2996-2998).

**The reference to the Master was actually in the case commenced by respondent against George A. Ball; but by consent of the parties the entire record in that case, including the report of the Special Master, was made a part of the record in this case (R. 140, 141).

under which all that Van Sweringens were to do was to manage Midamerica for which they were to receive (apart from current compensation) a ten year option to buy 8250 shares of Midamerica common at $1 per share exercisable after they had paid or adjusted their debts.

(2) Even if Ball and Tomlinson made the kind of agreement the court below found—which petitioner denies —there can be no recovery, because, under the findings, Van Sweringens entered into an arrangement under which they were to procure for Midamerica a bargain purchase of the securities pledged by C.T.B. and Vaness, and in consideration of this they were to receive the 8250 shares of Midamerica common. Respondent was required to prove and rely upon this agreement. The activities of Van Sweringens under this agreement constituted a serious violation of their fiduciary duties as the dominant officers and directors of C.T.B. and Vaness—and the lower courts have so found. The agreement was therefore illegal and contrary to public policy. In consequence, respondent, who must rely on the rights asserted to have accrued to Van Sweringens under this kind of agreement, cannot properly invoke the processes of a federal court to obtain a recovery.

(3) When Midland Bank sold its Midamerica stock to petitioner, Midland (and through Midland the other three banks whom respondent represents) took the identical position which petitioner took when it accepted the shares from Ball and exercised dominion over them, i.e., the position that all rights of Van Sweringens in respect of Midamerica stock had terminated. Respondent is therefore estopped to assert in this action that that position was wrongful.

QUESTIONS PRESENTED.

1. Where dominant directors and officers of a corporation have made an agreement involving a serious violation of fiduciary duty under which agreement they are to receive certain stock, may the successor in interest of those directors and officers recover for conversion of the stock (by reason of the refusal of the other party to the agreement to turn over the stock pursuant to the agreement and his gift of the same to petitioner) when in order to establish his right to the stock the successor in interest must prove and rely upon such an agreement?

2. Where the four beneficiaries of respondent's trust have taken the position in connection with Midland's sale of Midamerica stock to petitioner that all rights of Van Sweringens in respect of Midamerica stock had terminated upon their deaths and have derived a very substantial financial benefit from that sale, is respondent thereby estopped to assert against petitioner that Van Sweringens' rights in Midamerica stock had not terminated?

3. Where a person, who has subscribed and paid a large amount of money for the preferred and the common stock of a corporation, gives to an insolvent debtor, in consideration of personal services, an option to buy part of the common stock for a nominal amount after the debtor has become free of debts, is such a contract a fraud upon the insolvent debtor's existing creditors?

REASONS FOR GRANTING THE WRIT.

A. ON THE ILLEGALITY ISSUE.

First. The Court below has rendered a judgment based on a claim which is contrary to public policy under the applicable local decisions, to wit: a claim based on a contract to compensate Van Sweringens for services, the performance of which constituted a serious violation of fiduciary duty by Van Sweringens who were the dominant officers and directors of C.T.B. and Vaness.

Second. The case presents the following important questions of federal law which have not been, but should be, settled by this Court:

(a) Whether a contract involving a serious breach of fiduciary duty by the dominant directors of a corporation whose securities are widely distributed is contrary to the public policy of the United States; and

(b) Whether federal courts in cases where jurisdiction is based solely on diversity of citizenship should enforce a claim which is contrary to the public policy of the United States.

Third. If such a contract is contrary to the public policy of the United States, then the decision of the Court below is in conflict with the decision of this Court in *McMullen v. Hoffman*, 174 U. S. 639.

Fourth. The decision of the Court below is in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *In re The Van Sweringen Company*, 119 F. (2d) 231, on substantially the same matter.

B. ON THE ESTOPPEL ISSUE.

The Court below has decided an important question of local law in a way in conflict with the applicable local decisions in that it has held that respondent is not estopped by reason of the conduct of his beneficiaries other than the Midland Bank.

C. ON THE FRAUD OF CREDITORS ISSUE.

The Court below has decided an important question of local law in a way in conflict with the applicable local decisions, to wit: It has held to be in fraud of creditors an agreement under which Van Sweringens were not to have the right to acquire Midamerica stock until they had paid or adjusted their debts.

WHEREFORE petitioner respectfully prays that a writ of certiorari issue to the Circuit Court of Appeals for the Seventh Circuit requiring that Court to certify and send to this Court for its review and determination a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket "No. 8433, H. Earl Cook, Superintendent of Banks of the State of Ohio in Charge of the Liquidation of The Union Trust Company, Cleveland, Ohio, Trustee, vs. George and Frances Ball Foundation," and that the judgment of said Circuit Court of Appeals in said case be reversed by this Court.

Petitioner's brief in support of his petition is annexed hereto.

WILLIAM H. THOMPSON,

PERRY E. O'NEAL,
1350 Consolidated Building,
Indianapolis, Indiana,

PRESTON BOYDEN,

JOHN S. MILLER,
134 So. LaSalle Street,
Chicago, Illinois,

EVERETT WARNER,
Western Reserve Building,
Muncie, Indiana,

P. J. MULLIGAN,

ROGER P. BRENNAN,
1759 Union Commerce Building,
Cleveland, Ohio,

Counsel for Petitioner George and Frances Ball Foundation.